

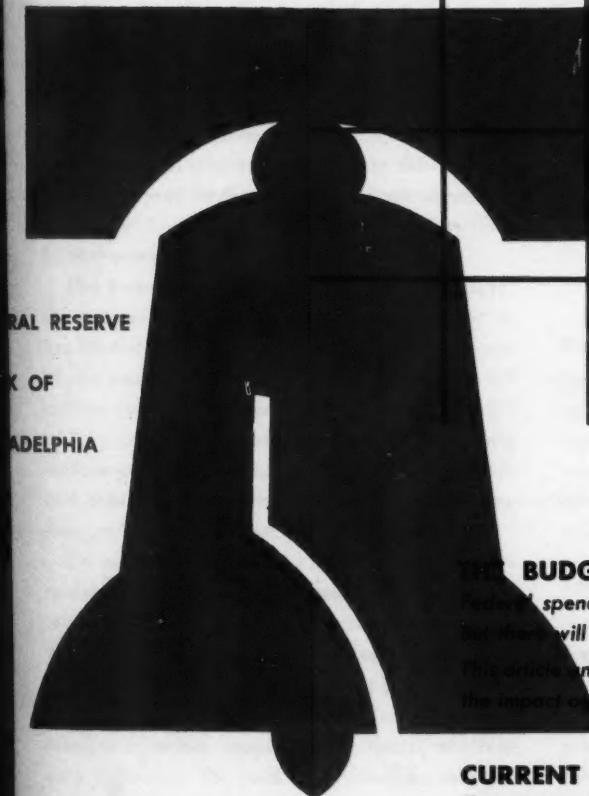
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FEBRUARY 1955

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MONEY MARKET
EFFECT

business review



BUDGET FOR 1956

Federal spending is expected to be down slightly, receipts up. But there will be a budget deficit.

This article analyzes where the money goes, where it comes from, the impact on the economy, and how public spending is controlled.

CURRENT TRENDS

Optimism stems partly from the fact that 1954 turned out as expected. There may be pitfalls in this point of view.

*Additional copies of this issue are available
upon request to the Department of Research,
Federal Reserve Bank of Philadelphia,
Philadelphia 1, Pa.*



THE BUDGET FOR 1956

The Federal Government expects to spend \$62.4 billion in fiscal 1956.* This is a rate of \$5 billion a month, \$171 million a day, or a dollar a day for every man, woman, and child in the country. In this one year the Government will spend enough to pay for 6 million \$10,000-homes or 21 million \$3,000-automobiles.

The Federal Government is the biggest buyer, the biggest employer, and the biggest debtor in the United States. In 1954 it bought 14 per cent of our total output of goods and services, had 3.3 million in the armed services, and employed 2.2 million civilians—about 3.6 per cent of total civilian employment. At the end of 1953 the Federal debt was 40 per cent of the total outstanding debt, public and private.

To most of us, perhaps, the budget document seems like a formidable mass of statistics—of interest only to the economist and the statistician. These statistics may appear impersonal in the budget document but they become more personal when reflected in our tax bill. The budget affects the amount of money people have to spend, which in turn influences the level of production, employment, and income.

* The fiscal year begins July 1 and ends June 30. Except when noted otherwise, reference in this article will be to fiscal years rather than calendar years.

This article will deal with four questions of general concern about the new budget:

1. Where does the money go?
2. Where does the money come from?
3. What will be the impact on the economy?
4. What methods have been established to keep public expenditures under control?

ADMINISTRATIVE BUDGET

The administrative budget shows expenses and income in a bookkeeping sense—expenses to be incurred and receipts expected to accrue to the Government during the year—not the amounts actually to be paid out and received from the public. The budget totals are: expenditures \$62.4 billion, receipts \$60 billion, deficit \$2.4 billion.

Where does the money go?

The Constitution provides that the Congress must authorize or appropriate funds before obligations can be incurred or expenses paid. Contracts for heavy durables such as airplanes and ships or major construction projects may require two or three years for fulfillment. Funds must be appropriated before contracts can be let, but a good part of the expenditure may not be made until subsequent fiscal years. The relation of expendi-

tures in 1956 to past and new authorizations is as follows:

BUDGET EXPENSES IN 1956

(in billions of dollars)

From previous authorizations.....	25.0
From authorizations requested in 1956 budget.....	39.0
From balances of revolving and management funds.....	1.6*
Total expenses.....	62.4
* Deduct	

The expenses of the Federal Government cover a great variety of activities. A useful classification is to break expenses down into three categories: national security, the cost of past wars, and non-defense expenditures. This breakdown shows the importance of defense as compared to non-defense activities.

It is not surprising in these days of international tension that providing for our national security accounts for the bulk of Federal expenditures. National security will take about two-thirds of the budget dollar in 1956—approximately the same proportion as in the current fiscal year. When the lingering cost of past wars is added, current and past defense take 82 cents and non-defense activities only 18 cents of each dollar of expenditures.

National security

Protecting the United States against the threat of external aggression requires the maintenance of large and well-equipped defense forces. The rearmament program initiated by the outbreak of hostilities in Korea brought a substantial increase in the number in the Armed Forces. New and improved weapons were needed to equip them. The expenses of the Defense Department rose rapidly and remain at a high level. Atomic energy development, military aid to friendly foreign countries, and stockpiling of strategic materials are also a part of our over-all national security

program. The bulk of national security expenditures—about 84 per cent—goes for Department of Defense activities. Foreign military aid accounts for 9 per cent; atomic energy, 5 per cent; and stockpiling strategic materials, only 2 per cent.

The cost of Department of Defense activities is estimated at \$34 billion for 1956. The largest amount, \$15.6 billion, is for the Air Force, reflecting the emphasis on air power for national defense. Of the remainder, \$9.7 billion is for the Navy and \$8.9 billion for the Army. These military expenditures for 1956 are about the same as estimates for the current fiscal year. There is a slight increase for the Air Force, and small reductions for the Army and Navy.

The three big items in military expenditures are equipment, personnel, and operations and maintenance, in the order named. Modern warfare requires vast quantities of military supplies and equipment. Technological advances have increased both the complexity and the cost of modern weapons. The cost of military hardware such as aircraft, ships, tanks, trucks, guns, and ammunition has been running at nearly two-fifths of total military expenditures. About three-fifths of equipment expenditures are for aircraft. Procurement other than aircraft and ships takes about one-third of the total.

Personnel costs, the second largest category of military expenditures, include such items as compensation of military personnel, family allowances, subsistence, clothing, and transportation. There are now 3.3 million in the Armed Forces, but present plans call for a reduction to about 3 million by mid-1955 and to about 2.8 million by mid-1956. The reduction in personnel, however, is not expected to bring a decrease in expenditures in 1956 because of the pay increase and other benefits recommended in the President's budget message. The cost of operations and maintenance

of equipment will take about one-fourth of total military expenditures planned for 1956.

Military public works include the construction of military bases, housing, and other facilities for military personnel. Construction expenditures are expected to increase in 1956. Research and development expenditures have remained steady in recent years at about \$1.4 billion. Historically, research expenditures are at a high level—reflecting emphasis on the development of new equipment and new techniques to provide our Armed Forces with the best and most modern equipment possible.

Past defense

Wars are not only expensive during hostilities; some of the costs continue for many years afterward. The principal costs are interest on the Federal debt and veterans' services and benefits. Interest on the Federal debt amounts to \$6.3 billion in 1956. The bulk of the debt was incurred in financing World War II and therefore represents a continuing cost of that war.

The cost of veterans' services and benefits is \$4.7 billion—a slight increase over 1955. There are now about 21 million veterans who, with the members of their families, constitute about 40 per cent of our population. Congress has provided for a wide variety of aids and benefits to veterans of previous wars. The largest item is for pensions and compensation for death or disability resulting from service in the Armed Forces. This accounts for more than one-half of the total. The next largest item is for hospital and medical care. Other benefits such as education and training, loan guarantees, and unemployment compensation designed to assist veterans to readjust to civilian life account for most of the remainder.

If these continuing costs of past wars, totaling about \$11 billion, are added to expenditures for

current security, about 82 per cent of the 1956 budget will go to pay for current and past defense. National defense is the primary reason for the high cost of Federal Government.

Non-defense

The remainder of 1956 budget expenditures, which amount to \$11 billion or 18 per cent of the total, covers a wide variety of Government activities. The principal non-defense expenditures are for international affairs, welfare, health and education, agriculture and agricultural resources, natural resources, commerce and manpower, and general government.

One of the major non-defense items is the cost of agricultural programs. Gross expenditures for 1956 are estimated at \$7.6 billion; however, repayment on loans and receipts from sales of commodities are expected to reduce net expenditures to \$2.3 billion. The most expensive program is that of supporting the price of farm products. Farm price support is expected to cost only about one-half as much as in the current fiscal year. The reduction reflects continued acreage restrictions, lower support levels on some commodities, and an expected increase in receipts from sales of surplus commodities held in storage.

A second major non-defense expenditure is for programs under the general heading of commerce and manpower. They include such activities as the promotion of transportation and communications, aid in the development of public and private housing, promotion of defense production, and the cost of administering employment and unemployment programs. Net expenditures of \$2.2 billion are somewhat less than for the current year but substantially above actual expenditures in 1954. The largest item—about one-third of the total—is for Federal aid to states for highway construction. Other expenditures to promote

transportation are Federal aid for navigation, including the St. Lawrence River project, the promotion of aviation, and assistance to the merchant marine. Although gross expenditures for urban development and redevelopment and private and public housing programs are expected to be substantial, net expenditures are small.

Welfare, health and education expenditures continue at the level estimated for the current fiscal year. The bulk of the cost is for assistance to the aged and needy. Most of the remainder goes to promote public health and to provide assistance for schools in areas where enrollment has been pushed up significantly by activities of the Federal Government.

The President recommends that an additional \$5 million be spent to improve important statistical programs. Improvements planned are principally in data on employment, unemployment, and industrial injuries; construction and housing, including data on residential vacancies and an intercensal housing census; and a survey of the present pattern of farmers' expenditures. More complete information will be helpful in carrying out the objectives of the Employment Act of 1946 which, among other things, directs that the

resources and activities of the Government be used to help maintain and promote "maximum employment, production, and purchasing power."

Trend in expenses

Federal expenditures moved sharply upward after the rearmament program got under way following the outbreak of hostilities in Korea. The post-war peak was reached in 1953. Expenses for 1956 are about \$11 billion below the peak reached in 1953—about 90 per cent of the reduction being in defense. Expenditures of the Air Force have held steady at around \$15 billion annually. There have been substantial reductions, however, for the other two services—nearly one-half for the Army and 18 per cent for the Navy.

Changes in the principal categories of defense expenditures are shown in the following table. Almost one-half of the total reduction in defense spending since 1953 has been in procurement other than aircraft and ships. For one thing, the cessation of fighting in Korea stopped the destruction of supplies and equipment in combat. Inventories of some items were sufficient to "live off the shelf" for a while. Then, too, the inventories of "short lead" items could be built up to desired

DEFENSE EXPENDITURES—1953-1956

(Fiscal years. In billions.)

Category	1953 (actual)		1954 (actual)		1955 (est.)		1956 (est.)	
	Amount	%	Amount	%	Amount	%	Amount	%
Personnel	\$11.6	26.6	\$11.0	27.3	\$10.2	29.7	\$10.3	30.3
Operation and maintenance	10.4	23.9	9.4	23.3	7.9	23.0	8.6	25.3
Major procurement and production—								
total	17.1	39.2	16.0	39.7	12.6	36.6	12.7	37.4
Aircraft	(7.4)		(8.3)		(7.6)		(7.6)	
Ships	(1.2)		(1.1)		(0.9)		(1.0)	
Other	(8.5)		(6.5)		(4.2)		(4.2)	
Public works	1.9	4.4	1.7	4.2	1.4	4.1	1.7	5.0
Other activities	2.6	6.0	2.3	5.5	2.3	6.7	.7	2.1
Total	43.6	100.0	40.3	100.0	34.4	100.0	34.0	100.0

Note: Figures may not add to totals because of rounding.

levels more rapidly than the heavier, more complex items requiring a longer time to produce. The armistice also made possible a substantial reduction in the cost of operations and maintenance. The continued high level of expenditures for aircraft reflects the new defense policy of relying more heavily on air power.

If we take a longer-term look at Federal expenditures, we find that the cost of war and national defense has been the dominant factor. Just prior to World War I, Federal Government activities cost around \$700 million a year. By 1919 the cost had risen to more than \$18 billion. There was a sharp decline following the war but expenditures did not return to their pre-war level. Expenses such as interest on the debt and veterans' benefits continue for many years. Nevertheless, Federal expenditures during the twenties were at a relatively low level, but rose considerably in the thirties because of the depression. Even so, expenditures in 1939 were only \$9 billion; then World War II lifted them to a peak of approximately \$100 billion in 1945. Following the end of the war, Federal expenditures declined to a low of \$33 billion in 1948 and then rose sharply with the outbreak of hostilities in Korea.

The bulk of all taxes collected by the Federal Government has gone to pay the cost of war and national defense. Expenditures, however, are not an accurate indication of the real burden of providing Government services. Although the cost of Government has risen sharply, principally because of war, so has the income to pay for it. In 1916 only 1.6 cents of each dollar of national income were needed to pay the expenses of the Federal Government. World War I lifted expenses much more than income, and in 1919 expenditures were equal to 27 per cent of national income. Expenses rose more rapidly than income in the thirties and during World War II. At the peak in

1945 they were over 50 per cent of national income. A reduction in expenditures and a rise in national income brought the percentage down to 16 in 1948; however, the rearmament program raised it to 23 in 1954.

Where does the money come from?

The Federal Government, as any institution, can pay out only what it has on hand, what it takes in, or what it borrows. In 1956, revenue is expected to fall short of expenses by \$2.4 billion. In estimating total receipts of \$60 billion, which is somewhat above that for the current fiscal year, it was assumed that the recovery in business activity and the rise in personal and corporate incomes would continue, and that excise tax rates and the corporate income tax rate would continue at present levels as recommended by the President.

The bulk of Federal revenue comes from taxes on income. Approximately five-sixths of budget receipts are expected to be derived from this source in 1956. One-half of net receipts will come from the tax on personal income and nearly one-third from the tax on corporate income. The remainder is derived mostly from excise taxes on manufacturers, alcohol, and tobacco.

Although budget receipts are expected to fall short of expenditures, the Government will not necessarily need to borrow from the public. Such need is determined by the relation between cash receipts and cash payments, which will be considered later.

ECONOMIC IMPACT

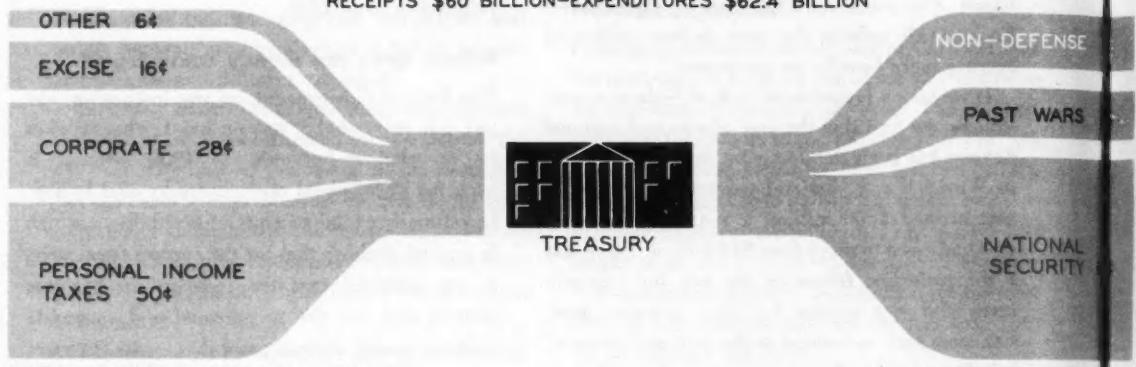
The financial operations of the Government have an important effect on business activity and employment. The amount of money the public has to spend is influenced by the amounts the Treasury

Continued on page 10

FINANCIAL OPERATIONS OF THE

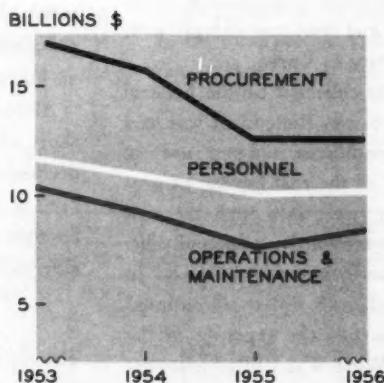
THE 1956 BUDGET

RECEIPTS \$60 BILLION—EXPENDITURES \$62.4 BILLION

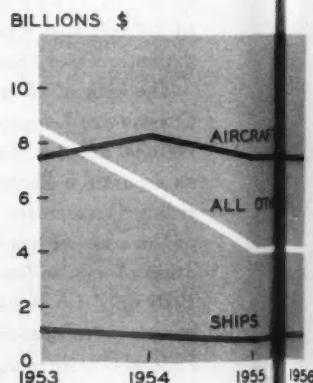


HERE IS WHERE THE TAX DOLLAR COMES FROM....

....HERE IS WHERE IT GOES



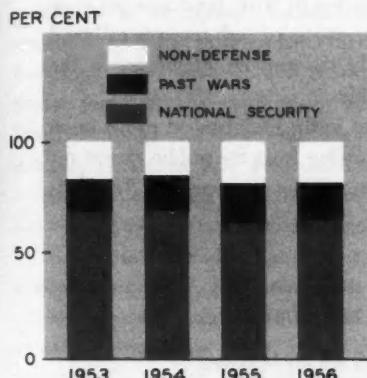
4. Defense spending has declined recently, mostly because of the drop in procurement



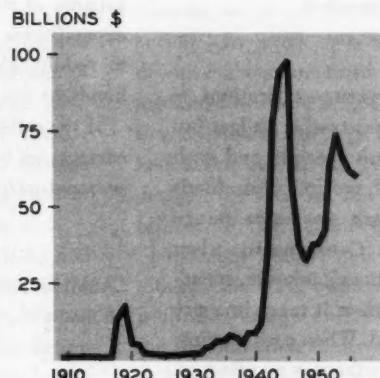
5. A large part of military expenditure is for aircraft

NOTE: ALL DATA FOR FISCAL YEARS

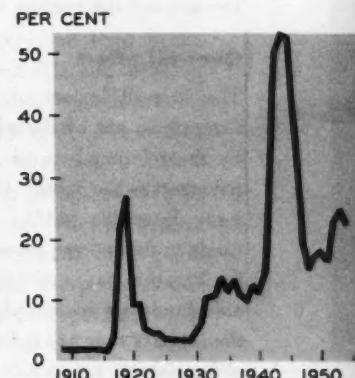
THE FEDERAL GOVERNMENT



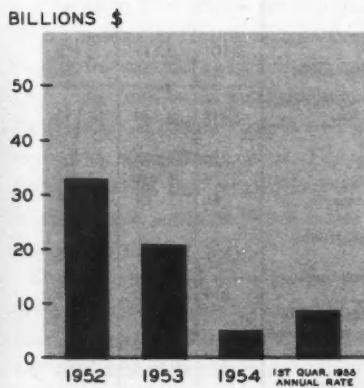
1. Current and past defense take the bulk of the budget dollar



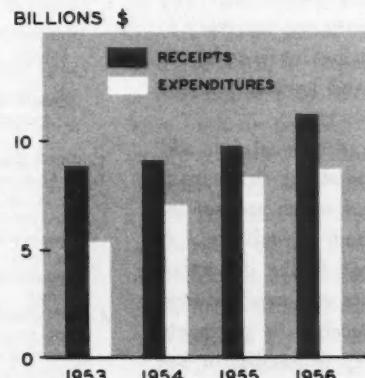
2. Federal spending has risen sharply over the years, mainly because of war and defense



3. Federal expenditures have taken an increasing proportion of the national income



6. New defense orders for hard goods dropped sharply and then turned upward



7. Trust fund receipts exceed expenditures. They are included in the cash, but not the administrative, budget

takes in and pays out. The high level of Government spending is in itself an important source of demand. Last year, Federal purchases of \$50 billion took 14 per cent of the total output of goods and services. Treasury operations, in addition to influencing buying power and the total demand for goods and services, affect the distribution of income and the pattern of demand.

Over-all effect

The over-all impact of Treasury operations is determined not by the administrative budget but by the relation between cash receipts and cash payments to the public. Cash receipts drain funds away from the public. Cash payments return funds to the income stream. Consequently, when the Treasury pays out more than it takes in, spendable funds are increased; when it takes in more than it pays they are reduced. When cash receipts and payments are in balance there is no effect on spendable funds because payments return as much to the income stream as receipts siphon out.

The cash consolidated budget shows the flow of money between the Federal Government and the public. Several adjustments are necessary to convert the administrative budget into a cash budget showing receipts from and payments to the public.

One of the most important adjustments is to add the transactions of the trust funds which are managed by the Government and which are not included in budget receipts and expenditures. A second important adjustment is the deduction of intragovernmental receipts and expenditures. Transactions resulting in receipts or payments from one Government agency to another or between Government agencies and the trust funds are offsetting; and they are neither from nor to the public. A third adjustment must be made for expenses which do not result in a cash payment

during the fiscal year, chiefly interest on savings bonds which accrues as an expense but is not actually paid out until the bonds are redeemed. There are many other minor adjustments which will not be dealt with here. The cash budget shows a surplus of \$558 million in contrast to the \$2.4 billion deficit in the administrative budget, primarily because of the excess in trust fund receipts over expenditures. The excess of cash receipts will tend to reduce slightly the amount of money in the hands of the public.

If the estimates in the cash budget prove to be correct, net borrowing from the public except for seasonal purposes will not be necessary. The Fed-

CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

(In millions of dollars)

Description	1954 actual	1955 estimate	1956 estimate
Receipts			
Budget receipts	64,655	59,000	60,000
Trust fund receipts.....	9,155	9,804	11,283
Less:			
Intragovernmental trans- actions	2,101	2,111	2,455
Other minor adjustments..	73	45	35
Equals: Federal receipts from the public.....	71,636	66,649	68,793
Payments			
Budget expenditures	67,772	63,504	62,408
Trust fund expenditures....	7,204	8,404	8,845
Other minor adjustments....	46	64	—67
Less:			
Intragovernmental trans- actions	2,101	2,111	2,455
Noncash debt transactions (net)	619	740	545
Plus: Net expenditures or re- ceipts (—) of Government- sponsored enterprises.....	—435	—96	49
Equals: Federal payments to the public	71,868	69,026	68,235
Excess of Federal receipts from the public.....	.....	.....	558
Excess of Federal payments to the public	232	2,377	.....

eral debt is likely to rise somewhat, however, as excess receipts of the trust funds are invested in Government securities, mostly special issues.

Among industries

The Federal Government is the largest single buyer in our markets. The impact of Government purchases is widespread because they cover a multitude of items, ranging from office supplies to buildings; from gasoline and lubricating oils to tanks, jeeps, trucks, and heavy aircraft; from food, clothing, and other subsistence items for military personnel to a great variety of modern weapons with which to equip them. The bulk of the buying, however, is in durable goods.

The decline in Federal purchases in 1954 had a depressing effect, particularly on some of the durable goods industries. Purchases dropped from an annual rate of \$60 billion in the second quarter of calendar 1953 to \$48 billion in the third quarter of calendar 1954. The major part of the decline was in defense purchases.

The initial impact of Government purchases results when new orders are placed. In the case of soft goods there is only a short time lag between the placing of orders and delivery and actual payment. The time lag is much longer, however, for the heavier and more complicated weapons such as modern aircraft and ships. For many of these heavy durables the interval between the placing of orders and actual delivery varies from one to two or more years.

For the long-lead durables the placing of new orders is significant indicator of the impact on those industries. New orders initiate a demand for raw materials, working capital, and labor required in manufacturing the products. The flow of new orders has had an important influence on inventory policy and rate of production in certain durable goods industries such as transporta-

tion equipment and primary metals, where defense orders represent an important part of their total business. New military orders for hard goods rose sharply following the outbreak of hostilities in Korea, and reached a peak of \$33 billion in 1952. This was an important reason for the increase in inventories and the rise in output of manufacturers of durable goods during that period. In 1953, new orders for hard goods dropped about one-third. But this had little immediate downward drag on durable goods production because of the large backlog of orders which had accumulated. In 1954 there was a drastic decline, the total for the year being less than \$6 billion. In the second quarter (fourth quarter of calendar 1953), new orders for hard goods totaled only \$362 million. The sharp contraction in the flow of new orders was an important reason for the reduction in inventories and the decrease in output of durable manufactures in the latter part of calendar 1953 and most of calendar 1954.

The budget estimates for purchases of items of defense equipment in 1956 are about the same as for 1955, with over one-half of the total being for aircraft. The prospects are that defense orders for hard goods will be larger in 1955, however, than in 1954 but still far below the volume of the defense build-up period. The recent rise has been mostly in follow-on orders; that is, orders to manufacturers who have been producing the goods. The principal effect will be to help sustain output rather than to initiate an expansion in their inventories and purchases of equipment.

The indications are that the Federal budget will exert more of a stabilizing force in the remainder of 1955, and perhaps in 1956, than in 1954. The small cash surplus for 1956 indicates little effect on the total supply of spendable funds. A somewhat higher level of new defense orders will have a stabilizing effect on the durable goods indus-

tries in contrast to the downward pressure exerted by the sharp decline in 1954.

CONTROLLING EXPENDITURES

The high level of Federal expenditures in recent years has focused attention on the problem of controlling public expenditures. For this reason, it may be well to review briefly budget procedure and some of the problems involved.

Responsibility for the budget is primarily two-fold. The Executive Branch is responsible for preparing the budget, and Congress must appropriate funds before any expenditures can be made. The Budget and Accounting Act of 1921, which created the Budget Bureau and made it directly responsible to the President, marked a significant advance in that all spending requests are centralized in a single budget which, together with an estimate of revenue, is submitted to the Congress.

Preparation of the budget

The Federal budget has become so large and complex that its preparation is almost a continuous process. Once the President has submitted his budget to the Congress in January, initial steps are soon taken toward preparing a budget for the following fiscal year. To illustrate, steps will soon be taken by the Budget Bureau toward preparation of the budget for fiscal 1957—that is, the year beginning July 1, 1956. It will be more concrete if we indicate the major phases involved in preparing the 1957 budget.

In the first phase, which will begin shortly, the staff of the Budget Bureau will start discussions with the various departments and agencies with respect to their programs for 1957. The information gathered from these discussions will enable the Budget Bureau to form some judgment as to the general outlook for the fiscal year. On the basis of the information obtained, the Budget

Bureau can prepare some tentative estimate of total expenditures and, perhaps after discussions with the President, formulate certain objectives and policies to serve as guides in final preparation of the new budget.

A second phase is inaugurated usually about June when requests go to the head of each department or agency for detailed estimates of their expenditures for the new fiscal year. Departmental and agency estimates are usually returned to the Bureau of the Budget around September. These requests are then reviewed carefully by the Bureau. If it appears that requests should be pared down, discussions will be held with officials of the department or agencies concerned. After carefully reviewing the departmental requests, the Bureau of the Budget arrives at estimates for each department and agency and consolidates them into an over-all budget which is presented to the President. The budget, as approved by the President, is then submitted to the Congress in January.

It is apparent that the Bureau of the Budget spends the greater part of the calendar year in preparing a budget for the fiscal year beginning the following July. In other words, preparation of the budget for fiscal 1957 will require the greater part of calendar 1955.

Congressional procedure

When the budget is received by the Congress in January it is referred to the Committee on Appropriations of the House of Representatives. The Committee and its staff make a study of the budget requests. Appropriation bills are prepared and hearings are held, giving members of the Committee an opportunity to question representatives of the various Government departments and agencies and the Bureau of the Budget as to the need for the funds requested. The Appropriations

Committee then reports out the bills to the full membership of the House. The bills are then debated, sometimes amended, and finally passed by the House.

They then go to the Senate where a similar procedure is followed. If the appropriation bills are changed in the Senate they are referred to a joint committee of the House and the Senate where the differences are ironed out. Once the bills are finally approved by the House and the Senate, they go to the President for his signature. The President must either approve or veto an appropriation bill as a whole; he cannot veto specific items. Appropriation bills must be passed by Congress and signed by the President by the end of June if funds are to be available for the beginning of the new fiscal year.

This brief summary is sufficient to show that present procedure provides for several reviews of spending requests while the budget is in process of preparation. Departmental and agency requests are first reviewed by the Bureau of the Budget, then by the President, the appropriations committees, and finally by the Congress as a whole. It would seem that running spending requests through this wringer of reviews would assure that any "water" would be squeezed out before the process is completed.

The problem of determining the minimum

amounts essential for carrying out the various Governmental programs and activities is a most difficult one. The Government has grown so large that the budget has become a vast and complicated document of 1800 pages, including the appendix, and weighing 8 pounds. Neither adequate staff nor time is available to those responsible for review to determine whether the many programs and activities could be carried out for less than the amounts requested, and if so by how much.

Limitation of prior authorizations

Advance authorizations are necessary for purchases of major defense weapons that require considerable time to produce, and for other programs covering more than one year. The fact that funds for about 40 per cent of 1956 expenditures have been appropriated and largely committed leaves less leeway for trimming expenses.

There are other expenditures determined by the provisions of previous legislation, such as veterans' services and benefits, the agricultural stabilization program, grants-in-aid to state and local governments, and Government contributions to Federal employees' retirement funds. Except for savings in administrative costs, such expenses can be reduced only by legislative action. These expenses and interest on the debt are estimated at \$14.8 billion in 1956.

CURRENT TRENDS

Now that the forecasting season is behind them, business analysts are turning to the less exciting job of checking current trends against their predictions. Thus far there is nothing to indicate that business will not rise moderately during 1955, in accordance with the consensus of forecasts. Production has been increasing, construction is exceptionally active for this time of year, consumer spending is at a high level, and inventory adjustments seem to be about over. Favorable forecasts plus favorable current trends have generated a feeling of confidence that is pervading the business community.

Business forecasters themselves seem more confident, not only about the business outlook but about their ability to *predict* the business outlook. Behind their confidence is the fact that 1954 behaved pretty much as expected. Most analysts predicted that business would decline only slightly. Gross national product in 1954 actually turned out to be only about 2½ per cent below 1953.

The strength which the economy revealed in 1954 gives sound reason for confidence in the future; but the success in predicting what happened in 1954 is illusory. Analysts were quite close in their forecasts of over-all magnitudes, like gross national product, but most of us missed pretty badly when it came to particular segments of the economy. We greatly underestimated cuts in spending by the Federal Government, and the strength of spending for both construction and consumers' goods. It just happened that our errors cancelled out.

The errors can be explained, of course, in hindsight. Perhaps the most popular explanation is that the strength of long-run growth forces buoyed

the economy against temporary depressants. Now that these short-run adjustments have been completed, the argument goes, the economy is free to move upward on its long-run growth curve. This analysis may well be correct, but it sometimes seems to induce a sort of happy fatalism—a philosophy of "relax and enjoy it."

At the opposite extreme, both the mildness of the late recession and the apparent success in predicting it may have made us over-confident in our ability to *determine* events. You sometimes get the impression that serious recessions no longer can happen because we now can tell when trouble is coming and what to do about it.

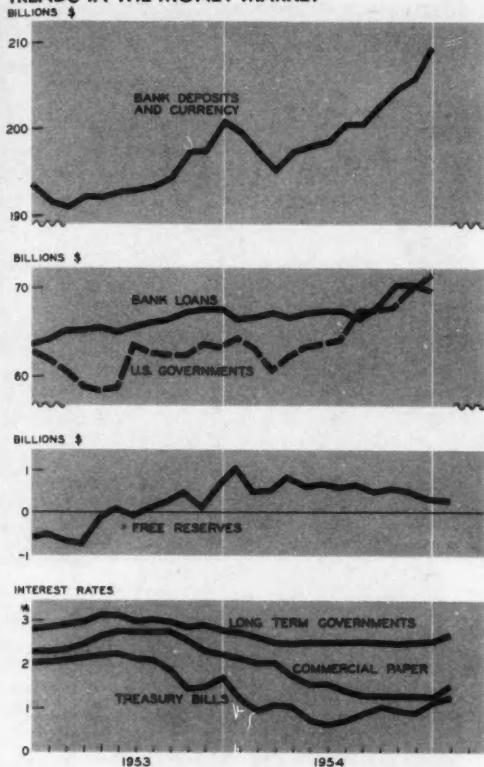
All this is not to say that forecasts for 1955 are wrong. It is simply an attempt to point out that many unforeseen developments could prove them wrong, and we can't always count on our errors cancelling out as they did in 1954.

Changes in the money market

One reason 1954 turned out as well as expected was that conditions in the money market were favorable to expansion. As the chart shows, the money supply—deposits and currency—did not decline as it usually does in a recession; in fact it rose to an all-time peak. The next two lines show why: banks expanded their loans; and they began, in early 1954, rapidly to increase their holdings of Government securities.

At the same time, in response to actions of the monetary authorities, the volume of "free" reserves of banks (i.e., excess reserves less borrowings from the Federal Reserve Banks) remained adequate to encourage an expansion of bank credit. As a result, interest rates declined.

TRENDS IN THE MONEY MARKET



Some of these conditions have changed recently along with the revival of business activity and growing optimism. The money supply continued to increase in the last quarter of 1954, but because of rising bank loans—not holdings of Government securities. The volume of free reserves has been gradually growing smaller, making it somewhat less easy for banks to expand credit. And interest rates have risen a little, more noticeably in the case of Treasury bills than commercial paper and long-term Governments.

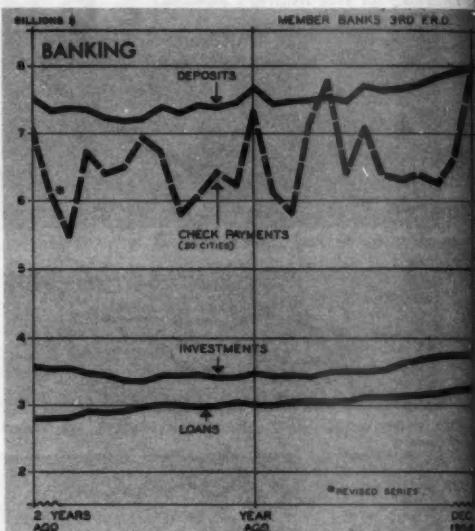
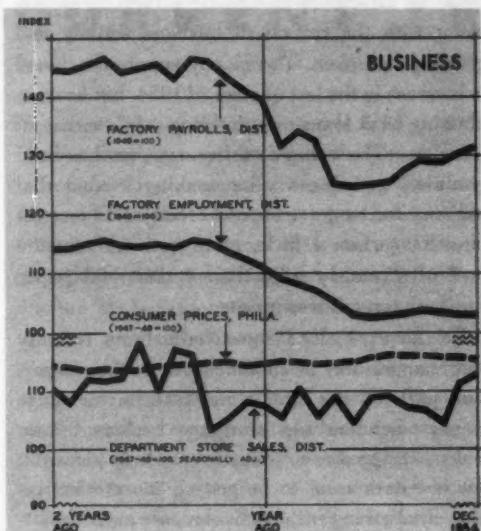
We have received some indications recently that changes may be imminent in another important part of the credit market—in mortgage money. Lenders and mortgage brokers tell us that mortgage money today is relatively plentiful, but investors seem to be getting more selective. They are looking with particular care at G.I. mortgages with no down payments and thirty years to run.

Terms on mortgages have not changed much in the past six months, but could change in the relatively near future. Take-out commitments on future loans are becoming harder to obtain, and some observers believe mortgage money may get tighter.



THIRD FEDERAL RESERVE DISTRICT

FOR THE RECORD...



SUMMARY	Third Federal Reserve District				United States			
	Per cent change				Per cent change			
	December 1954 from		12 mos. 1954 from year ago		December 1954 from		12 mos. 1954 from year ago	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
OUTPUT								
Manufacturing production	0	- 8	-13	- 2	+ 4	- 7		
Construction contracts*	- 3	+24	+21	- 9	+26	+13		
Coal mining.....	+ 3	- 2	-20	0	+ 6	-14		
EMPLOYMENT AND INCOME								
Factory employment (Total)	0	- 7	- 9	0	- 4	- 7		
Factory wage income.....	+ 1	- 6	-11					
TRADE**								
Department store sales	+ 1	+ 4	- 2	+ 4	+ 4	- 1		
Department store stocks.....	+ 2	+ 3		- 1		0		
BANKING								
(All member banks)								
Deposits.....	+ 1	+ 4	+ 4	+ 1	+ 5	+ 4		
Loans.....	+ 1	+ 8	+ 6	+ 2	+ 4	+ 7		
Investments.....	+ 1	+ 8	+ 3	- 1	+11	+ 7		
U.S. Govt. securities.....	0	+ 5	+ 2	- 1	+10	+ 8		
Other.....	0	+15	+ 8	0	+12	+ 8		
Check payments.....	+22†	+10†	+ 5†	+19	+11	+ 7		
PRICES								
Wholesale					0	- 1	0	
Consumer.....	0†	+ 1†	+ 1†	0	- 1	0		

LOCAL CHANGES	Factory*				Department Store				Check Payments	
	Employ- ment		Payrolls		Sales		Stocks			
	Per cent change December 1954 from		Per cent change December 1954 from		Per cent change December 1954 from		Per cent change December 1954 from		Per cent change December 1954 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown...	0	- 8	- 3	- 9	.....	.....	.....	.....	+11	+11
Harrisburg...	0	-12	- 1	-17	.....	.....	.....	.....	+11	- 6
Lancaster...	0	- 3	- 1	+ 1	+44	-1	-23	+ 5	+ 6	+ 5
Philadelphia.	0	- 8	+1	- 5	+23	+5	-20	+ 5	+19	+ 9
Reading....	0	- 5	+1	- 4	+42	+4	-22	+ 5	+17	+12
Scranton....	0	- 4	- 1	- 5	+61	+5	-25	+12	+19	+ 7
Trenton.....	-1	- 6	+2	- 2	+48	0	-16	+ 2	+ 6	- 7
Wilkes-Barre	+1	- 2	+2	+ 1	+55	+9	-18	- 1	+15	+14
Wilmington.	0	- 5	+2	+ 1	+51	+8	-22	+ 4	+94	+28
York.....	0	- 6	+9	- 7	+67	-1	-96	- 9	+ 9	- 5

^aBased on 3-month moving averages.

**Adjusted for regional variation.

120 Cities
Philadelphia

*Not restricted to corporate limits of cities but covers areas of one or more counties.

